89-1988

No. ______

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

THE BERKSHIRE GAS COMPANY, *et al.*,
Petitioners,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

JOHN W. GLENDENING, JR.
BARBARA K. HEFFERNAN*
CHERYL L. JONES
SCHIFF HARDIN & WAITE
1101 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 857-0600

Attorneys for
The Berkshire Gas Company, et al.

June 20, 1990

**Counsel of Record*

[Additional Counsel Listed on Inside Front Cover]

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

James F. Bowe, Jr.
O. Julia Weller
Hunton & Williams
P.O. Box 19230
Washington, D.C. 20036
(202) 955-1500

Jeffrey L. Futter
Long Island Lighting Company
175 East Old Country Rd.
Hicksville, N.Y. 11801
(516) 933-4690

Attorneys for
Long Island Lighting Company

William J. Cronin
Jonathan D. Schneider
Huber Lawrence & Abell
99 Park Avenue
New York, N.Y. 10016
(212) 682-6200

Attorneys for
New York State Electric & Gas Corporation

David L. Konick
Cullen and Dykman
1225 19th St., N.W.
Washington, D.C. 20036
(202) 223-8890

Attorney for
The Brooklyn Union Gas Company

QUESTIONS PRESENTED

1. Whether the decision below fails to accord the Commission due discretion to carry out its statutory mandate to establish just and reasonable rates and therefore violates this Court's decision in *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

2. Whether the court of appeals effectively deprived the Commission of its primary jurisdiction by concluding that the filed rate doctrine had been violated in circumstances where the Commission has exercised its statutory authority to establish just and reasonable rates.

3. Whether the court of appeals exceeded its authority by extending the filed rate doctrine into matters concerning the allocation of costs among a pipeline's customers.

4. Whether the decision below improperly precludes the Commission from using a historical benchmark to allocate current costs, particularly where the use of the historical benchmark is required to establish just and reasonable rates.

PARTIES TO THE PROCEEDINGS

A list of all parties to the proceeding is included in the Appendix. App. J, *infra*, 201a-204a.

The following is a list of parties joining in this petition. Pursuant to Rule 29.1, parent companies and subsidiaries of each corporation are listed under each petitioner.

The Berkshire Gas Company has no parent or subsidiaries.

Blackstone Gas Company has no parent or subsidiaries.

Boston Gas Company
Parent: Eastern Enterprise.

The Brooklyn Union Gas Company has no parent or subsidiaries.

City of Holyoke, Massachusetts Gas and Electric Department has no parent or subsidiaries.

City of Westfield Gas and Electric Light Department has no parent or subsidiaries.

Colonial Gas Company
Subsidiary: Transgas, Inc.

Commonwealth Gas Company
Parent: Commonwealth Energy System.

Connecticut Natural Gas Corporation has no parent or subsidiaries.

EnergyNorth Natural Gas, Inc.
Parent: EnergyNorth, Inc.

Essex County Gas Company has no parent or subsidiaries.

Fitchburg Gas and Electric Light Company
Subsidiary: Fitchburg Energy Development Company.

Granite State Gas Transmission, Inc.
Parent: Bay State Gas Company.

Long Island Lighting Company has no parent or subsidiaries.

New York State Electric & Gas Corporation has no parent or subsidiaries.

The Southern Connecticut Gas Company
Parent: Connecticut Energy Corporation.

Valley Gas Company
Parent: Valley Resources, Inc.

Yankee Gas Services Company
Parent: Yankee Energy System, Inc.
Subsidiaries: Housatonic Company; Norcon.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Table of Authorities Continued

Table of Authorities Continued

Table of Authorities Continued

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

No. _____

THE BERKSHIRE GAS COMPANY, *et al.*,
*Petitioners,**

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioners hereby petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The decisions of the court of appeals are reported at 893 F.2d 349 (D.C. Cir. 1989) (App., *infra*, 1a-28a) and 898 F.2d 809 (D.C. Cir. 1990) (App. 29a-34a). The orders of the Federal Energy Regulatory Commission are re-

---

* The Berkshire Gas Company, *et al.* includes: The Berkshire Gas Company; Blackstone Gas Company; Boston Gas Company; Colonial Gas Company; Commonwealth Gas Company; Connecticut Natural Gas Corporation; EnergyNorth Natural Gas, Inc.; Essex County Gas Company; Fitchburg Gas and Electric Light Company; Granite State Gas Transmission, Inc.; City of Holyoke, Massachusetts Gas and Electric Department; The Southern Connecticut Gas Company; Valley Gas Company; City of Westfield Gas and Electric Light Department and Yankee Gas Services Company.

ported at 40 FERC (CCH) ¶ 63,008 (1987) (App. 37a-93a), 42 FERC (CCH) ¶ 61,175 (1988) (App. 94a-131a) and 43 FERC (CCH) ¶ 61,329 (1988) (App. 132a-170a).

JURISDICTION

The judgment of the court of appeals was entered on December 28, 1989, and a petition for rehearing was denied on March 30, 1990. App. 29a-34a. On April 23, 1990, the court of appeals granted a stay of its mandate until June 22, 1990 in order to permit parties time within which to file a petition for a writ of certiorari. App. 35a-36a. This Court has jurisdiction under 28 U.S.C. § 1254(1) (1982).

STATUTES AND REGULATIONS INVOLVED

Sections 4(a) and (d) of the Natural Gas Act ("NGA"), 15 U.S.C. § 717c(a) and (d) (1982) provide:

(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public.

Section 5(a) of the NGA, 15 U.S.C. § 717d(a) (1982) provides:

(a) Whenever the Commission, . . . shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or clas-

sification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order[.]

FEDERAL JURISDICTION

The basis for federal jurisdiction in the District of Columbia Circuit was Section 19(b) of the NGA, 15 U.S.C. § 717r (1982).

STATEMENT OF THE CASE

This case concerns several orders issued by the Federal Energy Regulatory Commission ("FERC" or "Commission") that provide for the recovery of a portion of the settlement costs incurred by Tennessee Gas Pipeline Company ("Tennessee") to resolve its outstanding "take-or-pay" liabilities and to reform its existing gas purchase contracts to contain market-responsive terms and conditions. In essence, this case poses the question of whether the Court of Appeals for the District of Columbia Circuit may deprive the Commission of the only vehicle available by which parties whose actions contributed to the incurrence of billions of dollars in costs may be called upon to bear a portion of those costs.

The Commission's decision herein represents the lead case for implementation on an industry-wide basis of a major portion of the regulatory solution to the take-or-pay crisis that has been plaguing the natural gas industry for the last decade. The Commission recently reported that through 1989 interstate natural gas pipelines have incurred over $8 billion in take-or-pay settlement costs and have recovered approximately $3.4 billion of these costs under the purchase deficiency allocation methodology just invalidated by the court below. Order No. 500-H, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 54 Fed. Reg. 52,344 (Dec. 21, 1989), III FERC Stats. & Regs. (Regulations Preambles) (CCH) ¶ 30,867, 31,523

(1989). In this case alone, take-or-pay settlement costs of up to $1.3 billion are involved.

The purchase deficiency allocation method utilized by the Commission in this case (and numerous other cases) allocates take-or-pay settlement costs among the pipeline's customers by comparing each customer's purchases during a "base period" (before the onset of the pipeline's take-or-pay problem) with subsequent purchases by the customer during a "deficiency period" (after the onset of the take-or-pay problem). The decision below invalidated the Commission's chosen methodology for allocation and recovery of Tennessee's take-or-pay settlement costs on the ground that the method violated the "filed rate doctrine." In so holding, the court of appeals completely ignored the fact that the purchase deficiency allocation method must be used if the Commission is to carry out its statutory responsibility to establish just and reasonable rates. If this unprecedented extension of the filed rate doctrine is permitted to stand, millions of dollars of take-or-pay settlement costs will be shifted to parties that are not responsible for Tennessee's incurrence of these costs. Conversely, those most culpable will substantially escape their responsibility for the incurrence of these massive costs.

If the decision below stands, its impact will extend beyond even the many take-or-pay proceedings involving the purchase deficiency allocation method. The unprecedented extension of the filed rate doctrine by the court of appeals promises to seriously constrict the Commission's future efforts to establish rates that assure that cost responsibility follows cost causation. In fact, other recent decisions by the District of Columbia Circuit have already demonstrated this fear to be well-founded. (*See infra*, 29-30).

Although the court below denied rehearing *en banc*, Chief Judge Wald and two other circuit judges issued a strongly worded dissent. The three dissenters would have found that the Commission orders in question did not violate the filed rate doctrine. Rather, they would have upheld the Commission's orders as a reasonable response to the take-

or-pay problem, particularly in the context of the massive structural changes that have occurred in the natural gas industry.

A. Historical Background

A predominant feature of the natural gas industry is the long-term nature of the gas supply and related service commitments. Interstate pipelines have a long-term obligation to serve their customers that is defined by the certificate issued by the Commission pursuant to Section 7(c) of the NGA. 15 U.S.C. § 717f(c) (1982). Indeed, the pipeline's obligation to render service survives even when the contract between the pipeline and its customer expires and can only be terminated when and if the Commission authorizes abandonment. 15 U.S.C. § 717f(b) (1982).

To carry out their sales service obligations, pipelines typically enter into long-term contracts with natural gas producers. The amounts contracted for are, as would be expected, a direct function of the pipeline's anticipated level of sales to its customers. The term "take or pay" refers to a contractual provision that requires the buyer (typically an interstate pipeline) to take a specified amount of natural gas on a monthly or an annual basis, or to pay for the specified minimum amount even if the agreed amount is not taken. Take-or-pay provisions were prevalent in interstate pipeline gas supply contracts executed during the 1970s and early 1980s. Likewise, during the same period, pipeline tariffs typically included a "minimum bill" provision that required the pipeline's customers to take or pay for a specified minimum amount of gas on a monthly or annual basis.

In the aftermath of the gas shortages and curtailments of the 1970s, a number of events converged to create what has become known as the take-or-pay problem. First, the Natural Gas Policy Act of 1978 ("NGPA") was passed by Congress. 15 U.S.C. §§ 3301, *et seq.* (1982). As described by this Court, the NGPA "comprehensively and dramatically changed the method of pricing natural gas produced in the United States." *Public Service Comm'n v. Mid-Lou-*

isiana Gas Co., 463 U.S. 319, 322 (1983). One of the key purposes of the Act was the "establishment of a statutory incentive price structure that would simultaneously promote production and reduce the regulatory burden." *Id.* at 331. Simply stated, the NGPA put in place a mechanism designed to raise natural gas prices to market levels in order to stimulate production.

Second, because of the supply curtailments of the mid-1970s, pipelines were anxious to secure long-term reserves of natural gas. At that time, pipelines had a "guaranteed" market because the natural gas industry was structured so that most of the pipeline's customers (*i.e.*, local distribution companies ("LDCs") and end-users) were unable to contract independently for natural gas supplies, and had to rely solely on sales service (containing minimum bill obligations) from their interstate pipeline suppliers. Pipelines, therefore, signed long-term purchase contracts containing extremely high take-or-pay requirements.

Several events then occurred that radically changed this "monopolistic" picture and caused many natural gas pipelines to experience a grave supply/demand imbalance. First, the price of oil (which competes with natural gas for some markets) fell from the high levels of the late 1970s. Second, the NGPA had its intended effects—gas prices increased and production was stimulated. Third, demand for natural gas fell, due in part to falling oil prices (which led to fuel switching), in part to the recession of the early 1980s, and in part to warmer than normal weather. 54 Fed. Reg. at 52,347. These changes left many pipelines with a portfolio of high-priced gas that could not be sold competitively.

Acting on its belief that the fundamental causes of the supply/demand imbalance were the "inflexible supply arrangements between producers, pipelines, LDCs, and consumers" and the general pipeline practice of refusing to transport gas in competition with its own sales, the Commission put into motion its long-range plan to restructure the natural gas industry along more competitive lines. *Id.*

As a first step, the Commission issued Order No. 380, which eliminated "variable" costs (*i.e.*, the cost of the gas itself) from the minimum bill provisions contained in the pipeline's tariff for service to its jurisdictional customers. *Elimination of Variable Costs from Certain Natural Gas Pipeline Minimum Commodity Bill Provisions*, 49 Fed. Reg. 22,778 (June 1, 1984), FERC Stats. & Regs. (Regulations Preambles 1982-1985 Transfer Binder) (CCH) ¶ 30,571 (1984), *aff'd in relevant part*, *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986). As a result, if a customer failed to purchase from the pipeline at the level required by the minimum bill, the pipeline was guaranteed recovery of only its "fixed" costs. Following Order No. 380, the Commission, in a series of pipeline specific cases, proceeded to eliminate the remaining fixed cost minimum bill. *See, e.g.*, *Tennessee Gas Pipeline Co. v. FERC*, 871 F.2d 1099 (D.C. Cir. 1989); *East Tennessee Natural Gas Co. v. FERC*, 863 F.2d 932 (D.C. Cir. 1988); *Transwestern Pipeline Co. v. FERC*, 820 F.2d 733 (5th Cir. 1987), *cert. denied*, 484 U.S. 1005 (1988).

The Commission then issued Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 50 Fed. Reg. 42,408 (Oct. 18, 1985), FERC Stats. & Regs. (Regulations Preambles 1982-1985 Transfer Binder) (CCH) ¶ 30,665 (1985), which the District of Columbia Circuit described as envisioning "a complete restructuring of the natural gas industry." *Associated Gas Distributors v. FERC*, 824 F.2d 981, 993 (D.C. Cir. 1987) ("*AGD I*"). In Order No. 436, the Commission concluded that the prevailing pipeline practice of refusing to transport gas that would displace the pipeline's own sales service was "unduly discriminatory." *Id.* The Commission therefore took two complementary actions. First, it required pipelines performing self-implementing transportation service to do so on a non-discriminatory basis, *i.e.*, to become "open-access" transporters. Second, it provided that all firm sales customers of interstate pipelines would be able to convert

increasing percentages of their firm sales service to firm transportation service.

Significantly, the Commission's regulatory initiatives did not remove the pipeline's long-term certificate obligation to serve its customers. The ultimate result of these actions by the Commission was that pipeline customers still had the right to demand their full contractual entitlement from the pipeline, but no longer had an obligation to take or at least pay for a minimum level of service. Moreover, neither Order No. 380, Order No. 436, nor the many cases eliminating the fixed cost minimum bill dealt with the mounting take-or-pay problem.

B. The Proceedings in this Case

By 1983 (even before the advent of Order Nos. 380 and 436), Tennessee began to experience a serious drop in its sales. While a number of Tennessee's LDC customers reduced their purchases from Tennessee to buy less expensive "spot market" gas, at least one of Tennessee's major pipeline customers favored its own more expensive affiliated production to avoid incurring take-or-pay on its own system. That pipeline is Columbia Gas Transmission Corporation ("Columbia"), the principal petitioner below. In fact, Columbia's cut-backs preceded Order No. 380 and were in clear violation of Tennessee's then effective minimum bill. *Columbia Gas Transmission Corp.*, 29 FERC (CCH) ¶ 61,203, 61,406-07 (1984). Significantly, many of Tennessee's other customers (including those joining in this petition) continued to purchase their full contractual entitlement from Tennessee despite the increasing gas costs because such customers did not have any competitive options. Indeed, until Tennessee became an open-access transporter in December of 1986 (which is after the period used by the Commission to allocate Tennessee's take-or-pay settlement costs), many of Tennessee's customers had no choice but to buy their full contractual entitlement from Tennessee.

Tennessee attempted to settle with its producers either by making nonrecoupable payments to "buy-out" its ex-

isting take-or-pay obligations, or by paying the producers to reform or "buy-down" the contracts to improve take-or-pay and other pricing provisions prospectively. These costs are referred to respectively as "buy-out" and "buy-down" costs, or collectively as "take-or-pay settlement costs" (or simply "settlement costs"). Under Commission practice at the time, these settlement costs could be recovered by Tennessee, if at all, only through its commodity rate as an addition to the cost of gas, and therefore could be recouped by Tennessee only to the extent that market conditions would permit.

It was in light of all of these circumstances that Tennessee made the rate filing which is the genesis of this proceeding. As a condition of becoming an open-access transporter, Tennessee requested authority to direct bill its customers 80% of its take-or-pay settlement costs, and thereby to achieve a guarantee of recovery of this portion of its settlement costs. Tennessee proposed to allocate its take-or-pay settlement costs among its customers under a three-part formula, in part based on the purchase deficiency allocation methodology.

The Commission issued an order rejecting immediate implementation of Tennessee's proposed direct billing mechanism on the ground that it had not been adequately justified. The issues of the reasonableness of the proposed billing mechanism and the prudence of Tennessee's purchasing practices were set for hearing. *Tennessee Gas Pipeline Co.*, 36 FERC (CCH) ¶ 61,032, 61,075-76 (1986).

The Commission also considered the take-or-pay problem on a generic basis. In early 1987, the Commission issued a proposed policy statement to establish guidelines for pipeline recovery of take-or-pay settlement costs. *Recovery of Take-or-Pay Buy-Out and Buy-Down Costs by Interstate Natural Gas Pipelines*, 38 FERC (CCH) ¶ 61,230 (1987). The Commission determined that, in order to further its objective of moving toward a more competitive market, it was necessary to allow pipelines to recover a portion of their settlement costs through a direct bill (or fixed de-

mand charge). The Commission was concerned that if pipelines were required to recover these costs as an add-on to the price of gas, pipeline gas would become even more unmarketable. The Commission further determined that, in return for the direct bill, pipelines should be required to absorb a portion of their settlement costs and that a 50-50 cost sharing between the pipelines and their customers "is equitable based on the nature, extent and causes of the take-or-pay problem." *Id.* at 61,726-27. As to the allocation of take-or-pay settlement costs among the pipeline's customers, the Commission found that it was reasonable "to base each customer's demand surcharge [*i.e.*, direct bill] on its cumulative deficiency of purchases in recent years (during which the current take-or-pay liabilities of pipelines were incurred) measured in relation to that customer's purchases during a representative prior period during which take-or-pay liabilities were not incurred." *Id.* at 61,727.

Following extensive hearings, an initial decision was issued by an administrative law judge which approved Tennessee's three-part recovery mechanism, but required Tennessee to absorb 50% (rather than the proposed 20%) of its settlement costs. In support of his decision, the judge made a number of important factual findings. For example, the judge found that "it is apparent that a decline in a customer's purchases from Tennessee translates directly to a decline in Tennessee's ability to meet its purchase obligations." *Tennessee Gas Pipeline Co.*, 40 FERC (CCH) ¶ 63,008, 65,082 (1987). In this regard, the judge noted that the purchase deficiencies of Tennessee's four major interstate pipeline customers "translate into a potential take-or-pay liability of $1.97 billion." *Id.* While the judge admitted that a precise tracing of liabilities to individual customers had not been done, his findings nonetheless illustrate "the order of magnitude of the take-or-pay problem caused by cutbacks of purchases . . . . [and] the need to establish a reasonable allocation mechanism to prevent these customers from escaping take-or-pay costs." *Id.* The judge concluded that recovery by Tennessee of its take-

or-pay settlement costs as an add-on to the cost of gas would place an unfair burden on "captive customers and permit others to escape from payment of these costs." *Id.* at 65,089.

Before the Commission could act on the judge's decision, the District of Columbia Circuit remanded Order No. 436 (in part because of the Commission's "apparent insouciance" in dealing with the take-or-pay crisis in the natural gas industry), *AGD I*, 824 F.2d at 1044. As a result, the Commission issued Order No. 500, which contained a final policy on pipeline recovery of take-or-pay payments. *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 52 Fed. Reg. 30,334 (Aug. 14, 1987), III FERC Stats. & Regs. (Regulations Preambles) (CCH) ¶ 30,761 (1987). Like the proposed policy statement, Order No. 500 was based on the concept of equitable sharing between the pipeline and its customers and provided that any pipeline which volunteered to absorb a portion of its take-or-pay settlement costs, would have the opportunity to recover through a direct bill an amount equal to the amount voluntarily absorbed (but no more than 50% of the total). The Commission affirmed the purchase deficiency method as a reasonable means to allocate among a pipeline's customers the portion of costs not absorbed by the pipeline. The Commission also directly rebutted arguments that the purchase deficiency allocation method and direct bill constituted retroactive ratemaking. As the Commission stated:

> There is nothing in the Commission's proposal which would retroactively change the rates pipelines have charged their customers in the past or which would involve imposing a rate increase for gas already sold. Rather, the proposed allocation method would enable pipelines to recover in their future rates costs which they have actually incurred but have not recouped.

52 Fed. Reg. at 30,343.

Soon thereafter, Tennessee submitted a unilateral offer of settlement, which provided for a 50-50 sharing of all take-or-pay settlement costs between Tennessee and its

customers. Tennessee proposed to recover the customers' share of the costs (a total of $750 million, which was later reduced by the Commission to $650 million) through a direct bill and to retain a three-part allocation mechanism.

Tennessee's settlement proposal generated a flood of opposition from Tennessee's customers, as well as five alternative proposals. Nonetheless, the Commission issued an order approving Tennessee's proposed settlement, subject to certain modifications not pertinent here. *Tennessee Gas Pipeline Co.*, 42 FERC (CCH) ¶ 61,175 (1988).

In response to a number of requests for rehearing, the Commission issued an order on rehearing, which reversed its earlier approval of Tennessee's three-part cost allocation method. The Commission found upon further review that allocating take-or-pay settlement costs on any basis other than purchase deficiencies was unreasonable because costs would be improperly assigned to customers who had continued to purchase at high levels and therefore had not contributed to Tennessee's take-or-pay exposure. *Tennessee Gas Pipeline Co.*, 43 FERC (CCH) ¶ 61,329, 61,930 (1988). In both its original order approving Tennessee's settlement and its order on rehearing, the Commission expressly rejected arguments that the purchase deficiency allocation method violated the rule against retroactive ratemaking. 42 FERC (CCH) at 61,630 and 43 FERC (CCH) at 61,932-33.

A number of parties filed in the District of Columbia Circuit for review of the Commission's orders in this proceeding. On December 28, 1989, the District of Columbia Circuit issued its decision, finding that the purchase deficiency allocation method approved by the Commission violates the filed rate doctrine. *Associated Gas Distributors v. FERC*, 893 F.2d 349 (D.C. Cir. 1989) ("*AGD II*"). The court rejected the argument that take-or-pay settlement costs are "current" costs which have simply been allocated by the Commission in an equitable manner that honors the cost causation principle. Instead, the court stated that "the relevant question is not which costs are 'current' and which

are 'past.' Rather, the appropriate inquiry seeks to identify the purchase decisions to which the costs are attached." *Id.* at 355. In so holding, the court relied almost entirely on its earlier decision in *Columbia Gas Transmission Corp. v. FERC*, 831 F.2d 1135 (D.C. Cir. 1987), *modified on reh'g*, 844 F.2d 879 (D.C. Cir. 1988) ("*Columbia I*") wherein it had concluded that the imposition of a surcharge to recover certain deferred costs constituted impermissible retroactive ratemaking. *Columbia I*, 831 F.2d at 1142. As in *Columbia I*, the court below concluded that "[p]roviding the necessary predictability is the whole purpose of the well established 'filed rate doctrine'. . . ." *AGD II*, 893 F.2d at 356. The court thus vacated and remanded the Commission's order.

The Commission, Tennessee, and several groups of Tennessee's customers petitioned the District of Columbia Circuit for rehearing and suggested rehearing *en banc*. On March 30, 1990, the court denied the petitions for rehearing and suggestions for rehearing *en banc*, with Chief Judge Wald, joined by Circuit Judges Mikva and Edwards, dissenting from the denial of rehearing *en banc*. *Associated Gas Distributors v. FERC*, 898 F.2d 809 (D.C. Cir. 1990). Chief Judge Wald noted:

> The panel's overly rigid interpretation of the filed rate doctrine to invalidate [the Commission's] Order leaves the FERC essentially powerless to take care of the take-or-pay crisis. . . .
>
> The significant effect of the invalidation of Order No. 500 on the functioning of the industry and on the FERC's ability to regulate this "quiet revolution" in the gas industry certainly seems important enough to warrant our *en banc* consideration.

Id. at 811.

The chief judge also contested the panel's holding that the Commission's "equitable sharing mechanism" violates the filed rate doctrine. In Judge Wald's view "[i]t is not at all clear that as it applies to consumers 'let off the

hook' by Order No. 436" (*i.e.*, petitioners below) that the filed rate doctrine has been violated. *Id.* Judge Wald noted that these customers in essence, received a "windfall" as a result of Order No. 436, because they were permitted to buy less gas than their contracts required at the previously negotiated "bulk rate." *Id.* Judge Wald stated that:

> The FERC's decision to reallocate some of these current costs did not violate the filed rate doctrine because the deal originally agreed to by the consumers had already been abrogated by the FERC. Neither the purchase decisions to which the consumers' original costs were attached nor the rates pursuant to them were still valid. It was a brand new world: there were no "old rates" to change.

Id.[1]

Following issuance of the court's order denying rehearing, the Commission, Tennessee, and a number of local distribution companies moved in the court of appeals for a stay of issuance of the mandate in *AGD II*. In support of its motion, the Commission informed the court of appeals that *AGD II* raised "significant questions, . . . warranting Supreme Court review as to the scope and proper application of the 'filed rate doctrine'," that "the Court's mandate promises to [cause] far-ranging industry dislocation," and that to avoid such dislocation "the more efficient route to follow in this case is to retain the status quo by staying the mandate, and permitting the Supreme Court to examine the substantial issues raised by this case." Federal Energy Regulatory Commission's Motion for Stay of Mandate Pending Application for a Writ of Certiorari, filed April 3, 1990 (No. 88-1385, D.C. Cir.) at pp. 3, 5 and 8. App. 195a-200a. On April 23, 1990, the District of Colum-

---

[1] The court's denial of rehearing was also accompanied by a statement of Circuit Judge Williams (a member of the original panel). In this statement Judge Williams noted that the court has "not always clearly distinguished between the filed rate doctrine and the retroactive ratemaking doctrine." *Id.* at 810. He then attempted to clarify the two doctrines.

bia Circuit stayed the issuance of its mandate in this proceeding for sixty days, until June 22, 1990. *Associated Gas Distributors v. FERC*, No. 88-1385 (D.C. Cir. Apr. 23, 1990). App. 35a-36a.

REASONS FOR GRANTING THE WRIT

This case presents a significant issue regarding the Commission's authority under Sections 4 and 5 of the NGA to set just and reasonable rates. The court below interpreted the filed rate doctrine in an unreasonably rigid manner that conflicts with the precedent of this Court, with prior precedent in the District of Columbia Circuit, and with the precedents in other circuits. Indeed, at least three judges of the District of Columbia Circuit appear to be of the view that the case was incorrectly decided.[2]

The decision below misapplied the filed rate doctrine in a manner that frustrates the Commission's ability to establish just and reasonable rates and usurps the Commission's role as the primary interpreter and administrator of the NGA in violation of this Court's decisions in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981) (Powell, J., dissenting, and Stevens, J., joined by Rehnquist, J., dissenting) and *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). The decision below erroneously finds that the filed rate doctrine has been violated in circumstances where the Commission has exercised its primary jurisdiction and has fully reviewed and approved the rates in question. If the decision stands, the Commission's ability to establish just and reasonable rates that honor the well established cost causation principle will be seriously constricted.

The decision below also unjustifiably extends the filed rate doctrine into the area of cost allocation, an area clearly

---

[2] Five members of the court of appeals in regular active service (including two members of the panel) opposed rehearing *en banc*, and three favored it. Two circuit judges in regular active service, one of who was a member of the original panel, did not participate in the order.

reserved to the Commission. Prior decisions of this Court teach that the courts are prohibited from questioning the Commission's method of determining just and reasonable rates. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944). Instead, it is the end result of the Commission's order which is important, *i.e.*, whether the resulting rates are just and reasonable. Here, the court of appeals has clearly extended its reviewing authority beyond these limits and is, in effect, dictating methods of cost allocation.

The court of appeals has set aside a major Commission decision which is the lead case implementing a significant aspect of the Commission's solution to the take-or-pay problem, a problem with which the entire natural gas industry, the Commission and the courts have struggled for many years. If the decision below is allowed to stand, serious industry-wide economic dislocations will result and those customers most responsible for the incurrence of millions of dollars in costs will substantially escape liability. Conversely, customers who had little, if anything, to do with the incurrence of these costs will be called upon to pay a disproportionately high share.

Finally, the importance of this case extends beyond even the take-or-pay controversy. Other recent decisions issued by the District of Columbia Circuit have already applied the court's new interpretion of the filed rate doctrine to the recovery of other types of costs. (*See infra*, 29-30). Consequently, the fear that the instant case will indeed prove to constrict the Commission's ability to set just and reasonable rates that honor the cost causation principle has already been proven well-founded.

A. The Decision Below Misconstrues the Filed Rate Doctrine in Conflict with the Decisions of this Court and in a Manner That Frustrates the Commission's Ability to Establish Just and Reasonable Rates

The court below has erroneously relied upon the filed rate doctrine to invalidate the Commission's chosen method of allocating current costs among a pipeline's customers. The court has done so in circumstances where the Com-

mission's primary jurisdiction has not been questioned by any party. The Commission has exercised its primary jurisdiction and has determined that the rates currently on file and being collected by Tennessee are just and reasonable. In so holding, the Commission rejected all of the other allocation methods suggested in the proceedings below on the ground that none would produce just and reasonable rates. 43 FERC (CCH) at 61,930. Consequently, if the decision below stands, the Commission will have no means of carrying out the statutory mandate of Section 4 of the NGA. In sum, the decision below constitutes an impermissible intrusion on the Commission's authority to administer the Natural Gas Act's requirement that all rates be "just and reasonable."

The decision below usurps the Commission's congressionally-mandated role as primary interpreter and administrator of the NGA, a role which this Court has held should remain with the administrative agency to which Congress has delegated those responsibilities, particularly where the rules to be reconciled and applied both derive from the agency's organic statute. In *Chevron*, 467 U.S. at 844-45, this Court held:

> We have long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer, and the principle of deference to administrative interpretations
>
>> "has been consistently followed by this Court whenever decision as to the meaning or reach of a statute has involved reconciling conflicting policies, and a full understanding of the force of the statutory policy in the given situation has depended upon more than ordinary knowledge respecting the matters subjected to agency regulations. [citations omitted]
>>
>> " . . . If [the agency's] choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we

> should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned." [citations omitted]

Accord, K Mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988).

The filed rate doctrine is, in essence, a procedural requirement designed to protect the Commission's primary jurisdiction to establish just and reasonable rates. The filed rate doctrine has its origins in decisions of this Court interpreting the Interstate Commerce Act. *See Lowden v. Simonds-Shields-Lonsdale Grain Co.*, 306 U.S. 516, 520-21 (1939); *Louisville & Nashville R.R. Co. v. Maxwell*, 237 U.S. 94, 97 (1915); and *Pennsylvania R.R. Co. v. International Coal Mining Co.*, 230 U.S. 184, 196-97 (1913). The "filed rate doctrine," as it applies to the NGA, was summarized in *Hall*, 453 U.S. at 573. The doctrine has its foundations in Sections 4(c) and (d) of the NGA. Those sections, respectively, "require sellers of natural gas in interstate commerce to file their rates with the Commission," *Id.* at 576-77, and prohibit regulated sellers from "collect[ing] a rate other than the one filed with the Commission." *Id.* at 577. " 'The considerations underlying the doctrine . . . are preservation of the agency's primary jurisdiction over reasonableness of rates and the need to insure that regulated companies charge only those rates of which the agency has been made cognizant.' " *Id.* at 577-78, *quoting City of Cleveland v. FPC*, 525 F.2d 845, 854 (D.C. Cir. 1976). The doctrine "embodies the policy which has been adopted by Congress in the regulation of interstate commerce in order to prevent unjust discrimination." *Maxwell*, 237 U.S. at 97.

As pointed out in Justice Stevens' dissenting opinion, there are four separate federal policies arguably implicated in *Hall*. 453 U.S. at 591. All four of these policies arise out of Section 4 of the NGA. First, Section 4(a) requires that all rates be "just and reasonable." *Id.* Second, Section 4(b) "expresses the strong federal policy—reflected in most regulatory statutes—against discriminatory pricing." *Id.* at

594. Third, Section 4(c) "expresses a policy favoring the public disclosure of all rates and charges." *Id.* Fourth, Section 4(d) "imposes a *procedural requirement* that is designed to protect the substantive policy interests reflected in the three preceding subsections." *Id.* at 595 (emphasis added).

The essence of the filed rate doctrine is found in the Section 4(d) "procedural requirement" that all rates be filed with the Commission. If none of the "substantive policies" found in Sections 4(a), (b) and (c) are being infringed, "it surely exalts procedure over substance to deny respondents relief." *Id.* While the majority and dissent in *Hall* disagreed on the issue of whether the Commission's primary jurisdiction was being preempted, the Court as a whole clearly agreed that the fundamental purpose of the filed rate doctrine is to preserve the Commission's primary jurisdiction to establish just and reasonable rates. *Id.* at 577-78, 595-96.

The District of Columbia Circuit has extended the filed rate doctrine well beyond its intended limits. Rather than focusing on the question of whether the Commission has exercised its primary jurisdiction, the court below (relying on its own earlier decisions) claims that the whole purpose of the filed rate doctrine is to provide "necessary predictability." 893 F.2d at 356. Such is not the holding of this Court in *Hall*. While notice of the rates one is expected to pay (*i.e.*, predictability) is one of the purposes of the filed rate doctrine, the decision below elevates the concept of notice into a cost avoidance doctrine. If the filed rate doctrine now stands for the proposition that a cost allocation method must provide customers with the opportunity to plan their purchases and avoid costs, then the District of Columbia Circuit has effectively overturned the cost causation principle.[3]

---

[3] The concept of "necessary predictability" appears to have first arisen in the District of Columbia Circuit's decision in *Electrical Dist. No. 1 v. FERC*, 774 F.2d 490 (D.C. Cir. 1985). That case is easily distinguishable from the instant case. In *Electrical Dist.*, the issue was

The filed rate doctrine does not provide a guarantee that rates will never be changed. *City of Cleveland*, 525 F.2d at 856. Rather, the protection offered by the filed rate doctrine is that a pipeline cannot change its rates without prior Commission approval and cannot charge rates other than those properly on file with the Commission. Once a pipeline files with the Commission to implement a change in its rates, the substantive provisions of Section 4 operate to assure the customer that only just and reasonable rates will be implemented. Consequently, the "necessary predictability" or "notice" to which customers are entitled is simply the assurance that the procedural requirements of the NGA are followed and the assurance that the Commission will exercise its authority to set just and reasonable rates.

In carrying out its statutory responsibility to establish just and reasonable rates, the Commission has routinely employed the cost causation principle. *See Alabama Electric Coop. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982) ("Properly designed rates should produce revenues from each class of customers which match, as closely as practicable, the costs to serve each class or individual customer."); and *Tennessee Gas Pipeline Co. v. FERC*, 871 F.2d 1099, 1106 (D.C. Cir. 1989) ("Order No. 500 . . . provides for a method of tracking the customer sources of take-or-pay liability more closely. . . . "). The court below totally ignored the fact that the Commission has often used past events or past "benchmarks" to allocate costs among a pipeline's customers and to design future rates. For example, certain types of fixed costs (known as "demand" costs) are typically allocated among customers on the basis of the customer's peak day purchases during a past period. *Mississippi River Fuel Corp. v. FPC*, 163 F.2d 433 (D.C. Cir. 1947). Likewise, during periods of gas supply cur-

---

when the Commission's decision regarding just and reasonable rates became effective. The court of appeals held that it was not until the *actual rates* were filed by the Commission. *Id.* at 493. Here, there has never been any claim that Tennessee charged new rates before they were filed with and made effective by the Commission.

tailments, customer allocations of current gas supplies have been tied to customer purchase levels from a prior period. *City of Willcox v. FPC*, 567 F.2d 394, 408-12 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1012 (1978).

It is undisputed that a significant factor in Tennessee's incurrence of take-or-pay liability was the decline in purchases by many of its customers. The Commission's decision to allocate the settlement costs incurred to resolve Tennessee's take-or-pay liability on the basis of customer purchase deficiencies thus honors the cost causation principle. The decision to use the purchase deficiency allocation method was well within the discretion afforded to the Commission to establish just and reasonable rates.

Unlike *Hall*, in the instant case there is no threat to the Commission's primary jurisdiction. The Commission has not been deprived of its rate-setting authority and no party claims otherwise. *See City of Cleveland*, 525 F.2d at 854. Moreover, the rates are properly on file with the Commission (as required by NGA Section 4(c)), and the filed rates are the only rates being charged (as required by NGA Section 4(d)). Consequently, there can be no claim of undue discrimination. Nothing more is required to satisfy the filed rate doctrine.

The decision of the court below unjustifiably expanded the filed rate doctrine and effectively found that the procedural requirements of the filed rate doctrine override the substantive requirement found in NGA Section 4(a) of just and reasonable rates. This is in clear contradiction to this Court's decision in *Hall*, interpreting the filed rate doctrine, and to this Court's decision in *Chevron*, directing that the administrative agency be permitted to reconcile the objectives of its organic statute.

B. The Decision Below Has Improperly Extended the Filed Rate Doctrine and/or the Rule Against Retroactive Ratemaking to Dictate Methods of Cost Allocation

The task of allocating costs among a pipeline's customers is a critical component in the process of setting

just and reasonable rates. This Court has recognized that "[a]llocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts." *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 589 (1945). This Court has also held that "the Commission [is] not bound to the use of any single formula or combination of formulae in determining rates." *Hope*, 320 U.S. at 602. Rather, "[u]nder the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling." *Id. See also Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968) ("[I]f the 'total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.' " (citation omitted)).

Until *AGD II*, neither the filed rate doctrine, nor the related rule against retroactive ratemaking, had ever been extended to matters of cost allocation. As stated above, the filed rate doctrine has been limited to the protection of the Commission's primary jurisdiction in the establishment of just and reasonable rates. Use of the rule against retroactive ratemaking has been limited to situations in which the costs in question were "past losses" or "deferred costs" that could and should have been recovered in a prior period. Neither doctrine has ever before been used to invalidate a method of cost allocation and to interfere in such a direct manner with the Commission's ability to set rates.

In *AGD II*, the District of Columbia Circuit has impermissibly extended the filed rate doctrine and/or the rule against retroactive ratemaking to dictate methods of cost allocation. This unwarranted extension violates the teaching of this Court in *Hope*, that "it is the result reached not the method employed which is controlling." 320 U.S. at 602. *Accord, Permian Basin*, 390 U.S. at 767 and *Colorado Interstate*, 324 U.S. at 589. The District of Columbia Circuit's unprecedented expansion of the filed rate doctrine into the area of cost allocation is not supported by the decisions of any other circuit. Instead, other circuits have properly limited these doctrines in accord with their intended purposes. Indeed, in cases issued by the same panel

of the District of Columbia Circuit after *AGD II*, the court has inconsistently applied these basic regulatory principles.[4]

The prohibition (or rule) against retroactive ratemaking is an outgrowth of the filed rate doctrine. *Southern California Edison Co. v. FERC*, 805 F.2d 1068, 1070, n.2 (D.C. Cir. 1986). As this Court explained in *Hall*, "the Commission itself has no power to alter a rate retroactively." 453 U.S. at 578. Instead, Section 5(a) of the NGA allows the Commission, upon finding that a rate is unjust or unreasonable, to "determine the just and reasonable rate . . . to be *thereafter* observed and in force." *Id.*, *quoting* § 5(a) 15 U.S.C. § 717d(a) (emphasis in original). It is this limitation on the Commission's statutory powers that "bars 'the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate.' " *Id.*, *quoting City of Piqua v. FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979).

The prohibition against retroactive ratemaking likewise bars a pipeline from belatedly recovering costs that should have been recovered in a prior period. As this Court stated in *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145, 152-53 (1962):

> [A] rate for one class or zone of customers may be found by the Commission to be too low, but the company cannot recoup its losses by making retroactive the higher rate subsequently allowed. . . . The com-

---

[4] Despite Circuit Judge Williams' recent attempt at clarification, it appears that at least the *AGD II* panel is using the terms "filed rate doctrine" and "retroactive ratemaking" synonymously. The court of appeals relied almost exclusively on its earlier decision in *Columbia I* as support for its decision in this case. In *Columbia I*, the court quite clearly held that a surcharge on past purchases violated the "prohibition against retroactive ratemaking." 831 F.2d at 1142. *See also Id.* at 1139, 1140. The District of Columbia Circuit's subsequent decisions in *Columbia Gas Transmission Corp. v. FERC*, 895 F.2d 791, 793 (D.C. Cir. 1990) ("*Columbia II*") and *Transwestern Pipeline Co. v. FERC*, 897 F.2d 570, 575-80 (D.C. Cir. 1990) make clear that the court is using the terms interchangeably.

> pany having . . . failed to collect a sufficient [return] must, under the theory of the Act, shoulder the hazards incident to its action including . . . its losses where its filed rate is found to be inadequate.

In every case where retroactive ratemaking has been found, the costs at issue were either "past losses" or "deferred costs." For example, in the District of Columbia Circuit, in two cases involving attempts by utilities to recover deferred fuel costs, the court upheld the Commission's determination that the imposition of a surcharge to recoup such "past losses" constituted impermissible retroactive ratemaking. *See Southern California*, 805 F.2d at 1070, n.2; and *Public Service Co. of New Hampshire v. FERC*, 600 F.2d 944, 956-61 (D.C. Cir. 1979). In *Public Service*, the court held that the "major issue . . . is whether this finding [of retroactive ratemaking] absolutely precludes approval of the surcharges." *Id.* at 956-57. The court held that it did and the utility was required to absorb the deferred fuel costs. *Id.* at 958. Conversely, in another decision by the District of Columbia Circuit, a Commission determination that a make-up provision was not illegal retroactive ratemaking was upheld because "the provision [did] not adjust for shortfalls in prior rates." *Public Systems v. FERC*, 709 F.2d 73, 85 (D.C. Cir. 1983).

Decisions issued by the First, Third, Fourth and Fifth Circuits provide no support for the District of Columbia Circuit's extension of the rule against retroactive ratemaking into the area of cost allocation. Instead, decisions by all of these circuits show that retroactive ratemaking has been limited to a determination of *whether* costs are recoverable (not how they are to be allocated if recoverable). *See Maine Public Service Co. v. FPC*, 579 F.2d 659, 667-68 (1st Cir. 1978), and *Maine Public Service Co. v. FERC*, 622 F.2d 23, 25 (1st Cir. 1980); *Boston Edison Co. v. FERC*, 611 F.2d 8 (1st Cir. 1979); *Jersey Central Power & Light Co. v. FERC*, 589 F.2d 142 (3rd Cir. 1978); *Virginia Electric & Power Co. v. FERC*, 580 F.2d 710 (4th Cir. 1978); and *Dorchester Gas Producing Co. v. FERC*, 848 F.2d 634, 636-37 (5th Cir. 1988).

In *Columbia I* (which the court of appeals relied on heavily in this case), the District of Columbia Circuit expressly found that the pipeline had an opportunity to file to recover the deferred costs at issue and had failed to do so. 831 F.2d at 1138. The court's finding of retroactive ratemaking thus appeared to be consistent with established precedent.

The decision by the court of appeals in the instant case, as well as subsequent decisions of the court, demonstrate that the court has in some recent cases, but not others, departed from this long line of precedent interpreting the rule against retroactive ratemaking. The decisions rendered by the District of Columbia Circuit in *AGD II*, *Columbia II* and *Transwestern* suggest that the rule against retroactive ratemaking may not prohibit the recovery of deferred costs, but rather, may prohibit the use of certain types of allocation methods as to current or deferred costs.

Although the District of Columbia Circuit elsewhere described its *AGD II* decision as "*disallowing* $650 million sought by pipeline in excess of prior charges," *Public Utilities Comm'n v. FERC*, 894 F.2d 1372, 1383 (D.C. Cir. 1990) (emphasis added), the *AGD II* court clearly contemplated that Tennessee's take-or-pay settlement costs could be recovered under an alternative passthrough mechanism. 893 F.2d at 352. Likewise, despite the court's prior holding in *Columbia I* that the costs at issue were deferred costs that could have been recovered in a prior period by the pipeline, in *Columbia II*, the court made clear its view that the deferred costs could be recovered in current rates. 895 F.2d at 797. Indeed, the court expressly recognized, but then dismissed, the fact that the Commission had found that recovery of these deferred costs as an add-on to the current sales rate would be inequitable. *Id.*

Finally, in *Transwestern*, the same panel issuing the *AGD II* decision found that the filed rate doctrine and/or the rule against retroactive ratemaking barred the imposition of a direct bill to recover purchased gas costs accrued by the pipeline before the Commission gave notice

of its intent to use a direct bill. 897 F.2d at 579. It is unclear from the *Transwestern* decision whether the costs accrued prior to the date notice was provided are not recoverable at all or whether an alternative recovery mechanism could be used to recover the costs.

In *Public Utilities*, on the other hand, the District of Columbia Circuit's holding is consistent with the traditional interpretation of the rule against retroactive ratemaking. In that case, in a decision endorsed by two of the three judges from the *AGD II* panel, the court found that the rule against retroactive ratemaking prohibited the Commission from ordering refunds below the level of rates that had already been found just and reasonable. 894 F.2d at 1382-83. The decision is thus consistent with the requirement that rates once found just and reasonable not be retroactively increased or decreased. The decision in no way contemplated that an alternative allocation scheme could be used to return the costs in question to the pipeline's customers.

As all of these decisions make clear, the District of Columbia Circuit has extended the filed rate doctrine and the rule against retroactive ratemaking into areas not contemplated by this Court in *Hall* and in violation of this Court's directive in *Hope* that it is the end result reached, not the method used, which is controlling. Moreover, the decisions of the court below (by the court's own admission) have certainly been less than clear. The *AGD II* decision conflicts with other decisions of the District of Columbia Circuit (both old and new) and with decisions of other circuits. Under these circumstances, this Court should exercise its supervisory jurisdiction and resolve the inconsistencies that the *AGD II* decision has injected into the filed rate doctrine and the rule against retroactive ratemaking.

C. The Case Presents Questions of Substantial Importance to the Entire Natural Gas Industry

If the purchase deficiency allocation method is eliminated, years of new litigation are sure to follow. Given

the Commission's express finding that the alternative methods presented in this case would not result in just and reasonable rates, it is not at all clear whether or how these costs can be recovered. Aside from challenges to any alternative recovery mechanism proposed by the pipeline, litigation regarding the prudence of Tennessee's purchasing practices will almost certainly result. Many of Tennessee's customers expressly conditioned the waiver of their challenges to the prudence of Tennessee's purchasing practices on acceptance of the purchase deficiency allocation method. If that method of allocation is rejected and customers' shares of Tennessee's costs escalate significantly, such customers will have the right to re-assert their prudence challenges. Given the extreme cost shifting that will result from the adoption of an alternative allocation method and the lack of assurance that Tennessee will not attempt to recover 100% of its settlement costs, customers may have no choice but to engage in further litigation.

The magnitude of the take-or-pay problem facing the natural gas industry is staggering. As earlier stated, by the end of 1989, on a nationwide basis, pipelines had incurred over $8 billion in take-or-pay settlement costs and approximately $3.4 billion of these costs have already been recovered by pipelines from their customers using the purchase deficiency allocation method. 54 Fed. Reg. 52,356-57. Indeed, the purchase deficiency allocation method has been used to allocate take-or-pay settlement costs on virtually every interstate pipeline. If the purchase deficiency allocation method is invalidated, literally billions of dollars will be shifted among customers without any consideration whatsoever of the basic ratemaking principle of cost causation.

Based upon figures provided by the Commission concerning other possible recovery mechanisms, the companies joining in this petition could be billed over 400% more if the Commission's present purchase deficiency allocation methodology is disallowed. On the other hand, Tennessee's interstate pipeline purchasers and their customers (as a group) will see very substantial decreases. More specifi-

cally, the Addendum to the Commission's Petition For Rehearing *en banc* filed February 12, 1990 in the court of appeals (App. 171a-191a) shows that Tennessee's large local distribution company customers (referred to as "CD" or contract demand customers) are currently expected to pay $37.2 million under the purchase deficiency allocation method approved by the Commission. If this method is invalidated, the amount paid by these customers will increase to either $128.9 million or $97.9 million, depending upon the alternative adopted by the Commission. The contribution made by Tennessee's interstate pipeline purchasers, on the other hand, would decrease from their current share of $409.5 million under the purchase deficiency allocation method, to either $246.9 million or $75.8 million, depending upon the alternative method adopted. Significantly, "the net benefit to Columbia of moving from the deficiency-based method to a volumetric method would be about $170 million." (App. 174a).

Nor will this cost shifting between customers stop with the first interstate pipeline and its customers. Many interstate pipelines (including Tennessee) have customers that are themselves interstate pipelines. It has been the Commission's policy to require "downstream" interstate pipelines to pass through the take-or-pay costs they incur on an "as-billed" basis. In other words, Tennessee's downstream pipeline customers also use the purchase deficiency allocation method to pass through to their own customers the take-or-pay costs they incur from Tennessee. Indeed, in some cases, more than one downstream pipeline is involved and multiple filings and refilings will therefore be required to distribute refunds and then implement a new recovery mechanism.

The strongly worded views of Chief Judge Wald and the other circuit judges dissenting from denial of rehearing *en banc* confirm the serious problems that would result if the decision below is permitted to stand:

> In a time when the structure of the natural gas industry is undergoing a sea change, the FERC must

> be granted considerable discretion to insure that the transition period is handled in a manner that minimizes the disruption in the industry.

898 F.2d at 811.

The three dissenting judges also clearly understood the untenable position that the panel's decision creates for the pipeline and the inequity of the decision as to consumers. In the words of the dissenters:

> The panel suggests that if pipelines wish to share their multi-billion dollar loss with consumers, they must do so by adding a surcharge to future sales. In a competitive market, of course, the "take-or-pay" pipelines will not be able to do this since such surcharges would raise their prices to an uncompetitive level. But even if some costs could be passed on to future consumers, that would still mean the total losses would be allocated *in*equitably. Those consumers who are in a position to take advantage of open-access shipping will bear proportionately less of the loss than those who cannot—even though the former (by switching to other pipelines) are the ones responsible for the loss.

Id. (emphasis in original).

It cannot be denied that the court of appeals' decision in *AGD II* presents questions of substantial importance to the entire natural gas industry in the context of the take-or-pay problem. The District of Columbia Circuit's unprecedented extension of the filed rate doctrine has not, however, been limited to cases involving only the recovery of take-or-pay settlement costs. The instant decision is one in a series of recent cases where the court of appeals has opined on the filed rate doctrine and the related rule against retroactive ratemaking. Most recently, in *Transwestern*, the same panel of the court found that the recovery of accrued purchased gas costs via a direct bill would violate the filed rate doctrine. 897 F.2d at 582. Similarly, the decisions by the court of appeals in *Columbia*

I and *Columbia II* extend the reach of the filed rate doctrine and retroactive ratemaking to the recovery of certain "production-related" costs. The costs at issue in the *Transwestern* and *Columbia I and II* cases are not unique to the pipelines involved in those cases. As in the instant case, those decisions will have immediate impact on other systems where pipelines are attempting to recover the same types of costs.

Although the court of appeals also denied petitions for rehearing and suggestions for rehearing *en banc* in *Transwestern*, (App. 192a-194a), the chief judge issued a separate statement reiterating the concerns expressed by the dissenters in *AGD II* and, in essence, requesting the intervention of this Court to resolve the controversy:

> I think the court's current interpretation of the filed rate doctrine is overly rigid, at a time when the FERC needs latitude to navigate the recent dramatic changes in the structure of the natural gas industry. . . . It remains for the Supreme Court to settle this important question of how impenetrable a barrier the filed rate doctrine is to FERC's efforts at allocating the inevitable burdens stemming from fundamental readjustment of the pipeline industry.

(App. 193a).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

JOHN W. GLENDENING, JR.
BARBARA K. HEFFERNAN*
CHERYL L. JONES
SCHIFF HARDIN & WAITE
1101 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 857-0600

Attorneys for
The Berkshire Gas Company, et al.

Counsel of Record

JAMES F. BOWE, JR.
O. JULIA WELLER
HUNTON & WILLIAMS
P. O. Box 19230
Washington, D.C. 20036
(202) 955-1500

JEFFREY L. FUTTER
LONG ISLAND LIGHTING COMPANY
175 East Old Country Rd.
Hicksville, N.Y. 11801
(516) 933-4690

Attorneys for
Long Island Lighting Company

WILLIAM J. CRONIN
JONATHAN D. SCHNEIDER
HUBER LAWRENCE & ABELL
99 Park Avenue
New York, N.Y. 10016
(212) 682-6200

Attorneys for
New York State Electric & Gas Corporation

DAVID L. KONICK
CULLEN AND DYKMAN
1225 19th St., N.W.
Washington, D.C. 20036
(202) 223-8890

Attorney for
The Brooklyn Union Gas Company

June 20, 1990